agreement continues to require the CLEC to establish a POI "in each Verizon Rate Center Area (or Exchange Area) where CLEC chooses to assign telephone numbers to its Customers,"[63] despite the fact that it has received Section 271 authority in three states. BellSouth's template agreement provides that each party may establish its own POI for the hand-off of its originating traffic, and imposes no restrictions on BellSouth's ability to select its POI(s).[64] The Commission cannot ignore the reality that the ILECs, who have suffered little more than a slap on the wrist for violating their interconnection obligations," will not voluntarily "split" the costs of transport with CLECs under either of the default transport rules proposed in the *NPRM.*

The Commission's second "rule of the road'' correctly imposes originating transport costs (from the customer to the POI) on the network of the carrier that serves the customer originating the call. Unlike the COBAK and BASICS default rules, the Commission's current transport rule is competitively neutral and easy to implement. If, as some ILECs allege, their end user rates do not recover the cost of transporting their traffic to the POI(s) selected by the CLEC, ILECs have two alternative means to correct the situation. ILECs can either petition their state commissions for authority to increase their local rates or make a cost-based showing under Section 252(d)(1) that a particular form of interconnection causes the ILEC to incur uncompensated costs that should not be

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http://www.qwest.com/about/media/pressroom/1,1720,328_archive,00.html?printVersion=1&xmlFilename=2000Sep19328&storyId=328).

63 Verizon Template Agreement at § 7.1.1.1.

64 BellSouth Interconnection Agreement, Attachment 3, §3.2.1.1 (available at http://www.interconnection.bellsouth.com/become_a_clec/html/ics_agreement.html).

65 For example, when the FCC recently found that BellSouth had not negotiated with Covad in good faith. it fined BellSouth only $750,000, approximately one-half of the amount it could have assessed. *See News Release FCC and BellSouth Enter into a $750,000 Consent Decree improving Compliance with Local Competition Rules* (Nov. 2, 2000).

recovered in its local rates. The Commission need not alter Rules 51.703(b) or 51.709(b) to address this situation.

VII. Bill-and-Keep Should Not, and May Not, Be Applied to the Exchange of Section 251(b)(5) Traffic

Section 251(b)(5) of the Act places on all local exchange carriers the duty to establish reciprocal compensation arrangements for the transport and termination of telecommunications.[66] Section 252(d)(2)(A) states that for terms and conditions for reciprocal compensation to be just and reasonable they must provide for "the mutual and reciprocal recovery by each carrier of costs associated with the transport and termination on each carrier's network facilities of calls that originate on the network facilities of the other carrier."[67] In addition. the rate must be determined on the basis of the '-additional costs of terminating such calls."[68]

While Section 252(d)(2)(B)(i) does not preclude use of bill-and-keep, it contemplates that reciprocal compensation arrangements will either "afford the mutual recovery of costs through the offsetting of reciprocal obligations [or] . . . waive mutual recovery [of costs].[69] The Commission currently allows states to impose bill-and-keep arrangements if "neither carrier has rebutted the presumption of symmetrical rates and if the volume of terminating traffic that originates on one network and terminates on another network is approximately equal to the volume of terminating traffic flowing in

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66 47 U.S.C § 251(b)(5).

67 47 U.S.C § 252(d)(2)(A).

68 47 U.S.C § 252(d)(2)(A)(ii).

69 47 **U.S.C.** § 252(d)(2)(B)(i).

the opposite direction, and is expected to remain so."[70] In interpreting the requirements of Section 252(d)(2)(A)(i) in the *Local Competition Order*, the Commission concluded:

> [I]n general, we find that carriers incur costs in terminating traffic that are not *de minimis*, and consequently, bill-and-keep arrangements that lack any provisions for compensation do not provide for recovery of costs. In addition, as long as the cost of terminating traffic is positive, bill-and-keep arrangements are not economically efficient because they distort carriers' incentives, encouraging them to overuse competing carriers' termination facilities by seeking customers that primarily originate traffic. On the other hand, when states impose symmetrical rates for the termination of traffic, payments from one carrier to the other can be expected to be offset by payments in the opposite direction when traffic from one network to the other is approximately balanced with traffic flowing in the other direction.[71]

The bill-and-keep arrangement contemplated by the Commission would not allow the mutual recovery of costs because it would not provide for compensation when there are traffic imbalances.[72] **A** LEC that terminates more traffic than it originates would not be able to recover its costs of transport and termination.[73] Transport and termination costs are real costs that carriers incur to deliver calls to their customers. Even if the cost of the loop was fully paid for by the customer, which the Commission has been loathe to require because of universal service and rate shock concerns, the carrier would still incur switching costs and costs to transport traffic to the called party. While the supply of long-haul fiber may, in theory, be inexhaustible, the supply of metropolitan network fiber

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70 *Local Competition Order* at ¶ 1111.

71 *Local Competition Order* at ¶ 1112.

72 This situation would be compounded if the Commission decided to employ bill-and-keep only for ISP-bound traffic and not for non-ISP-bound traffic. Then there would be both an asymmetry in rates and *the* likelihood of significant traffic imbalances.

73 **NARUC** expresses concern about whether bill and keep will "provide fair compensation to each carrier in the market, especially if there are imbalances in the type or volume of traffic between the carriers." *July 18, 2001 Resolution of the National Association of Regulatory Utility Commissioners Regarding the Development of a Unified "Bill-and-Keep" Intercarrier Compensation Regime. ("NARUC July 18 Intercarrier Compensation Resolution");see also, CC* Docket No. 96-98, Comments of BellSouth

is not. Building local transport is expensive.[74] **As** a result, LECs' transport and termination costs are not ***de** minimis.*

Unless the traffic flow between two carriers is balanced, a bill-and-keep arrangement does not provide for the mutual recovery of costs nor does it reasonably approximate "the additional costs of terminating such calls" as required by Section 252(d)(2)(A)(ii).[75] Even proponents of bill-and-keep in the *Local Competition Proceeding* acknowledged that such an approach is problematic if traffic is not balanced.[76] By removing the exemption that permits a carrier to rebut the presumption of balanced traffic, the Commission will contravene the requirements of Section 252 and deny carriers their statutory right to recover their costs for transporting and terminating other carriers' traffic. In effect, bill-and-keep would not eliminate, but would simply reverse, the opportunities for "regulatory arbitrage" by "encouraging [LECs] to overuse competing carriers' termination facilities by seeking customers that primarily originate traffic."[77]

Corporation at 3 (May 16, 1996); CC Docket No. 96-98, Comments of GTE Service Corporation at 55 (May 16, 1996).

[74] *See, e.g., Joint Petition of BellSouth, SBC, and Verizon for Elimination of Mandatory Unbundling of High-Capacity Loops and Dedicated Transport, CC* Docket No. 96-98, WorldCom Fleming Declaration at ¶ 8 (filed June 11, 2001) (cost of bringing a new building on net averages $250,000 per building), TDS Comments at 5 (filed June 11, 2001) (laying fiber in TDS' markets can cost up to $150,000 per mile).

[75] *GTE Local Competition Comments* at 55.

[76] *Local Competition Order* at ¶ 1103

[77] *Id.*; *see also,* CC Docket Nos. 96-98 and 99-68, ***Ex** Parte Letter of Time Warner Telecom to Secretary, FCC* at 5 (Oct. 20, 2000) ("*Time Warner **Ex** Parte"); see also, NARUC* **July** *18th Intercarrier Compensation Resolution* (Bill-and-keep may "create perverse incentives regarding infrastructure development, network configuration, or points of interconnection.")

The only situation in a which bill-and-keep arrangement should be allowed where traffic is not balanced is when the parties voluntarily agree to such an arrangement.[78] This is supported by the language in Section 252(d)(2)(B)(i) which states that the Section does not preclude "arrangements that ***waive*** mutual recovery (such as bill and keep arrangements"[79] (emphasis added). The only parties that can waive the right to mutual recovery of costs are the parties that are exchanging the traffic; the Commission cannot waive rights for them. The parties are in the best position to know if their traffic patterns are conducive to bill-and-keep and to weigh the advantages and disadvantages of implementing such a compensation scheme. Because a bill-and-keep regime must either afford the mutual recovery of costs or be invoked pursuant to a voluntary arrangement between the parties, the Commission cannot mandate bill-and-keep for all local traffic consistent with the Act.

Mandating bill-and-keep would also violate the Act by infringing on jurisdiction reserved to state commissions. While the Commission is permitted to promulgate regulations to implement Sections 251 and 252, Section 252(c)(2) entrusts the task of establishing rates to state commissions. If the Commission were to mandate bill-and-keep for Section 251(b)(5) traffic: it would be establishing a rate of zero, thus taking the task of rate setting out of the hands of the state commissions." Both *Iowa Utils. Bd.* and Section 2(b) of the Act prevent the Commission from taking such action.

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78 *See BellSouth Local Competition Comments* at 4 ("[u]nder the express language of the Act, bill-and-keep arrangements are only permissible where the parties voluntarily agree to waive mutual recovery of costs.")

79 47 U.S.C. § 252(d)(2)(B)(i) (emphasis added)

80 Even though the Commission stated it was exercising its authority over ISP-bound traffic under its interstate jurisdiction and Section 251(g), the Commission's recent order is already being challenged by the National Association of Regulatory Utility Commissioners ("NARUC") because it displaces reciprocal compensation rates for local traffic already established by state commissions. *July 18, 2001 National*

VIII. Bill-and-Keep May Not Be Separately Implemented for ISP-Bound Traffic

The *NPRM* suggests that the Commission is considering mandating bill-and-keep only for ISP-bound traffic.[81] Of all the regulatory scenarios posited in the *NPRM*, this would be the worst possible choice. It would also be the antithesis of the Commission's stated goal to establish a unified intercarrier compensation regime. Precluding carriers from recovering their costs for only one class of traffic would only create new opportunities for regulatory arbitrage. Furthermore, reversing the status **quo** only for calls made to customers CLECs have succeeded in capturing would send the message to the investment community that the Commission will change the rules if necessary to assure that CLECs are not successful. In its 1996 *Local Competition Order*, the Commission predicted that the intercarrier compensation rates for all classes of traffic would ultimately converge. Arbitrarily selecting one class of traffic and mandating a rate of zero for the exchange of such traffic would skew the market. in contravention of the Commission's goal to let markets, rather than regulators, determine prices.

A. There Is No Basis for Singling ISP-Bound Traffic Out for Bill-and-Keep Treatment

In its *Reciprocal Compensation Order*, the Commission concluded:

> we see no reason to impose different rates for ISP-bound and voice traffic. The record developed in response to the *Intercarrier Compensation NPRM* and the *Public Notice* fails to establish any inherent differences between the costs on any one network of delivering a voice call to a local end-user and a data call to an ISP. Assuming the two calls have otherwise identical characteristics (*e.g.*, duration and time of day), a LEC generally will incur the same costs when delivering a call to a local end-user as it

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Association of Regulatory Utility Commissioners Resolution on Jurisdictional Issues for Internet-Bound Traffic (*"NARUC July 18th Reciprocal Compensation Resolution")*. The Commission can thus be assured that state commissions will not sit back and let the Commission dictate a rate of zero for Section 251(b)(5) traffic.

81 *NPRM* at ¶ 66,

> does delivering a call to an **ISP.** We therefore are unwilling to take any action that results in the establishment of separate intercarrier compensation rates, terms, and conditions for local voice and ISP-bound traffic.[82]

Singling out ISP-bound traffic for bill-and-keep treatment would be an ill-advised retreat from this approach. It would also be contrary to any principles of rational decision-making since there is no dispute that transport and termination of ISP-bound calls relies on the same network functionality as the transport and termination of voice calls.[83]

B. Segregating ISP-Bound Traffic for Disparate Regulatory Treatment Would Send the Worst Possible Signals to the Market

CLECs did not create what the Commission terms the "regulatory arbitrage" of reciprocal compensation for ISP-bound traffic. CLECs initially advocated a bill-and-keep approach, at least where traffic patterns were balanced.[84] It was the ILECs that virulently opposed bill-and-keep - not for any overarching policy reason but for the simple reason that they presumed that CLECs would be terminating significantly more calls on their networks than vice versa.[85] The Commission directed that reciprocal compensation rates for the transport and termination of local traffic should be symmetrical. and set at the ILEC's incremental cost.[86] Assuming they would terminate a larger share of traffic than the CLECs with which they were interconnected, the ILECs sought to capitalize on the rule by demanding above-cost rates. In short, ILECs engaged in regulatory arbitrage by insisting upon above-cost reciprocal compensation rates that they thought would be their to benefit.

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82 *Reciprocal Compensation Order* at ¶ 90.

83 *Id.* at ¶ 90, n. 180.

84 *Local Competition Order* at ¶ 1**103.**

85 Shira Levine, *Compensation,* America's Network at 2 (June 1,2001).

The Commission observes that CMRS carriers appear to have voluntarily entered into agreements to exchange local traffic on a bill-and-keep basis. Incredibly, the Commission seeks "comment on why we have not seen unreasonable termination fees from CMRS firms while we have from wireline CLECs."[87] The Commission is, or should be, well aware that it is the ILECs who set the "unreasonable termination fees" in the first generation of interconnection agreements. Consistent with the Commission's directive that reciprocal compensation rates for ILECs and CLECs be symmetrical, CLECs charge the same termination rates as the ILECs. It is extremely disconcerting that the Commission reserves its criticism for "wireline CLECs" and makes no mention of the termination fees charged by the ILECs, despite the fact that it is the ILECs who are responsible for setting those termination rates.

After structuring the ground rules and setting the rates for reciprocal compensation in the first generation of interconnection agreements, ILECs found that the system did not work to their benefit. Their solution was to get the rules changed. They succeeded in convincing the Commission to significantly lower reciprocal compensation rates, impose growth caps on ISP-bound traffic eligible for reciprocal compensation, and require CLECs to implement bill-and-keep for ISP-bound traffic in markets entered after the effective date of the Commission's *Reciprocal* ***Compensation Order.***

A competitive entrant must have a starting point for its operations within a given market. Given the explosive growth in demand for access to the Internet, it made perfect sense for new market entrants to target new businesses that were providing that access. To penalize carriers for serving ISPs by denying them the ability to recover their costs for

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[86] *Local Competition* ***Order*** at ¶¶ **1085-1093.**

transport and termination would be contrary to the Act's goal of enhancing access to the Internet. In Section 254(h)(2) of the Act, Congress has directed the Commission to establish "competitively neutral rules" to enhance access to information services for all public and non-profit elementary and secondary school classrooms, health care providers and libraries. It would not be competitively neutral for the Commission to deny carriers the right to recover the costs of transporting and terminating other carriers' ISP-bound traffic nor would precluding such cost recovery enhance access to information services. As the Arizona Commission determined in an arbitration between Level *3* and Qwest, bill-and-keep:

> may be more appropriate when the amount of traffic is roughly balanced, however, in this case, Level *3* is a new entrant into the market and the traffic between Level *3* and Qwest is not balanced. Adopting a bill and keep approach would stifle competition in Arizona. If Level 3 and other CLECs are not compensated for services that they provide, then CLECs will not find it profitable to do business in Arizona."

A determination to implement bill-and-keep permanently for ISP-bound traffic only would do considerable harm. Such a rule would unfairly benefit ILECs by allowing them to be compensated for the CLEC voice traffic terminated on their networks, but relieving them of the obligation to pay for the data traffic they terminate on CLECs' networks. It would also be directly contrary to the Commission's conclusion that there are no inherent differences between the costs of delivering a voice call to a local end user and a data call to an ISP. The ILECs' reciprocal compensation complaints are truly of their own making and motivated by revenue preservation and anticompetitive objectives.

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87 *NPRM* at ¶ 95.

88 *Petition of Level 3 Communications, LLC for Arbitration Pursuant to Section 252(b) of the Communications Act of 1934, as Amended by the Telecommunications Act of 1996, with Qwest Corporation Regarding Rates, Terms, and Conditions for Interconnection,* **Docket** Nos. T-03654A-00-0822, T-01051B-00-0882, Opinion and Order, **8** (Ariz. CC **Apr.** 10,2001).

Singling out ISP-bound traffic for bill-and-keep would reward ILECs for refusing to embrace the facilities-based competition that Congress intended.

C. Imposition of Bill-and-Keep for ISP-Bound Traffic Only Is Not Competitively Neutral

Setting the rate for terminating ISP-bound traffic at zero and maintaining a positive rate for Section 251(b)(5) traffic would promote the very regulatory arbitrage opportunities the Commission seeks to prevent. **As** the Commission recently noted:

> It would be unwise as a policy matter, and patently unfair, to allow incumbent LECs to benefit from reduced intercarrier compensation rates for ISP-bound traffic, with respect to which they are net payors, while permitting them to exchange traffic at state reciprocal compensation rates, which are much higher than the caps we adopt here, when the traffic imbalance is reversed. Because we are concerned about the superior bargaining power of incumbent LECs, we will not allow them to "pick and choose" intercarrier compensation regimes, depending on the nature of the traffic exchanged with another carrier. The rate caps for ISP-bound traffic that we adopt here apply, therefore, *only* if an incumbent LEC offers to exchange all traffic subject to section 251(b)(5) at the same rate. Thus, if the applicable rate cap is $.0010/mou, the ILEC must offer to exchange section 251(b)(5) traffic at that same rate. Similarly, if an ILEC wishes to continue to exchange ISP-bound traffic on a bill-and-keep basis in a state that has ordered bill-and-keep, it must offer to exchange all section 251(b)(5) traffic on a bill-and-keep basis.[89]

Adopting bill-and-keep for only ISP-bound traffic would result in distinct regulatory classifications for different types of locally-dialed traffic that bear no relation to the costs incurred by the parties. In essence, the Commission would be favoring one type of locally-dialed traffic (voice) over another type of locally-dialed traffic (ISP-bound) by a price differential that favors termination of voice traffic. This would undoubtedly cause market distortions that could have long-term effects on the growth of

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89 *Reciprocal Compensation* ***Order*** at ¶ **88.**

the Internet and the efficient allocation of resources to local telecommunications infrastructure.

Moreover, such discrimination is contrary to Commission policies. As explained in more detail in Section IX.B, the Commission has pursued for over twenty years a policy of aligning rates with the manner in which costs are incurred. The Commission has also articulated in this proceeding the goal of eliminating artificial rate distinctions between classes of traffic that are terminated using identical network functions.[90] The Commission explicitly incorporated these two policies in its pricing rules for UNEs and reciprocal compensation. Specifically, Rule 51.705(a)(1) concerning rates for reciprocal compensation incorporates Rule 51.503(c), which provides that "[t]he rates that an incumbent LEC assesses for [termination] shall not vary on the basis of the class of customers served by the requesting carrier, or on the type of services that the requesting carrier purchasing such [termination services] uses them to provide."[91] To create a distinction in what LECs may charge one another for transport and termination based upon the content of the traffic or the identity of the customer receiving the call, rather than the cost of providing the service, would be discriminatory. Such discrimination is against Commission policy and the public interest. Accordingly, the Commission should not mandate bill-and-keep for any class of traffic and especially not for ISP-bound traffic only.

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90 *NPRM* at ¶ 12.

91 47 C.F.R. § 51.503(c).

IX. Bill-and-Keep Should Not Be Applied to Access Traffic

A. Bill-and-Keep for Access Charges Would Require a New Federal Regulatory Program that Would Increase End-User Rates

Access charges have historically been set far above the costs associated with origination and termination of traffic in order to provide revenues to LECs to cover the costs of their local networks used to complete the calls and to defer the costs of universal service.[92] Although the effectiveness and efficiency of this pricing structure is debatable, it is important to recognize that access charges cannot simply be swept away in favor of bill-and-keep without considering the impact on end-user rates and the Commission's universal service objectives.

Bill-and-keep for access would result in new federal end-user charges because LECs would need to recover all of the costs of providing interstate exchange access from their end users instead of IXCs. Because the separations process allocates a portion of local loop and local switching costs to the interstate jurisdiction, state commissions will not take responsibility for these charges and, therefore, will not permit LECs to bury them in local service rates. As explained previously, the Commission will need to establish new rules (at least for ILECs) governing the structure and level of end-user charges to recover the costs of interstate access.

In 1999, the Commission established competitive triggers, and Phase I deregulatory relief, for common line and traffic sensitive switched access services and the

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92 ***See*** *NPRM* at ¶ 7, n. **6.** The current access charge regime is derived from the "separation and settlement" practices of the former Bell System. These date back to **the** Supreme Court's decision in ***Smith v. Illinois Bell Tel. Co.***, 282 **U.S.** 133 (1930), which held that rates for long-distance calls must recover some of the costs of the local telephone facilities used in completing these calls.

traffic sensitive component of tandem-switched transport.[93] The Commission cannot assume that its competitive triggers and pricing flexibility framework would still be appropriate once some of these charges are levied on end users, rather than IXCs. Nor may the Commission count on the availability of competitive local service to discipline ILECs' end-user access rates. As the Commission knows, competitive alternatives to ILECs' local service are not ubiquitously available. Although CLECs have won market share. ILECs still serve over 91% of local access lines and over 95% of residential and small business access lines.[94] Therefore, if it mandates bill-and-keep for interstate access, the Commission must regulate for ILECs the rate structure and charges that would be imposed on end users. Furthermore, even under the COBAK and BASICS proposals, ILECs would continue to charge most IXCs for some form of tandem-switched transport. Thus, in addition to adopting new rules for the access charges moved to end users, the Commission would have to maintain its regulations for access charges that ILECs would still impose on IXCs. In short, bill-and-keep for interstate access charges would result in more, not less, federal regulation.

B. The Commission's Proposal Violates Its Preference for Recovering Costs in the Manner in Which They Are Incurred

The Commission has historically tried to set rates that reflect the manner in which costs are incurred. In the ***Intercarrier Compensation NPRM***, however, the Commission asks whether the end-user charge that replaces usage-sensitive carrier's carrier charges should be flat-rated.[95] In 1983, the Commission found that:

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93 ***Access Charge Reform, CC*** Docket No. 96-262, Fifth Report and Order, FCC 99-206 (rel. **Aug.** 27, 1999).

94 Industry Analysis Division, ***Local Competition:*** *Status as* ***of December 31,*** 2000 (May 2001).

95 *NPRM* at ¶ 123

> Provision of telephone services involves two marginal costs. One varies with the traffic level. The other varies with the number of access lines demanded. For this reason, efficient pricing requires both usage-sensitive and non-usage sensitive charges for recovery of access costs.[96]

Consistent with this finding, the Commission adopted a plan to phase in flat-rated charges for certain access functions so that rates would better reflect ILEC non-traffic sensitive ("NTS") costs. However. the Commission retained usage-sensitive charges for traffic sensitive ("TS") switching and common transport functions.[97]

In 1997, the Commission determined that the line cards and dedicated trunk ports in switches were NTS costs and should be recovered in flat-rated charges. However, because the record did not show that the shared costs of switching were NTS, the Commission refused to eliminate usage-sensitive charges for switching.[98] The Commission's *CALLS **Order*** again preserved usage-sensitive charges for local and tandem switching and common transport functions.[99]

In the *Intercarrier Compensation NPRM*, however, the Commission unbelievably now questions its historical premise that switching costs are traffic sensitive.[100] It asks whether flat-rated end-user charges should replace both usage-sensitive local switching and flat-rated PICCs collected from IXCs.[101] If the Commission reverses itself and determines that local switching costs should be recovered through flat-rated charges, it must provide a reasoned justification for abandoning its twenty-year policy that costs

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96 *MTS and WATS Market Structure,* CC Docket No. 78-72, Phase I, Third **Report** and Order, 93 F.C.C.2d 241, ¶ 27 (1983) ("*1983 Access Charge Order").*

97 *See Access Charge Reform Order* at ¶¶ 24, 37.

98 *Access Charge Reform Order* at ¶¶ 134-35.

99 *See, e.g., CALLS Order* at ¶ 176.

100 NPRM at ¶ 123.

101 *NPRM* at ¶ 123.

should be recovered in the manner in which they are incurred. If the justification for the reversal is that switching costs are not traffic sensitive after all, there must be some empirical evidence in the record to justify such a finding. Absent such evidence, the Commission may not alter its historical classification of switching costs as traffic sensitive.[102] Further, in order to be consistent, the Commission would have to require that ILECs recover tandem switching costs through a flat-rated charge for IXCs that continue to use ILEC transport to deliver traffic to the central office.

The Commission must also consider whether bill-and-keep for access would necessitate new regulations for non-dominant carriers. Absent wholesale re-regulation of IXCs, the Commission would not be able to ensure that IXCs pass through any access savings to consumers. For example, although the CALLS participants committed to passing though reductions in access charges,[103] consumer groups have complained that they are not living up to their commitments.[104] Adopting bill-and-keep for access could thus force the Commission to consider imposing new regulations on non-dominant carriers. Any such regulations would constitute not only a major policy shift, but also run counter to the deregulatory goals of the Act.[105]

Finally, the Commission must consider the impact bill-and-keep for access and these new federally-mandated end-user charges could have on rate averaging policies and

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102 *See CALLS Order* at ¶ 134.

103 *CALLS Order* at ¶ 34.

104 *See, e.g.*, Rick Kelsey, *Feds Rip AT&T for Raising Long-distance Rates* (June *7, 2000)* ("'AT&T promised to pass on savings to all consumers,' FCC Chairman William E. Kennard said in reference to **part** of an agreement last week to reduce long-distance access rates by **$3.2** billion. 'Their new rate plan does not do that. It is in our order and I am going to enforce it.'") (available at http://www.info-sec.com/abuse/00/abuse 060700a j.shtml); *AT&T Raises Basic Rates* (June 1, 2001) ("Consumer groups and rivals seized on the increase to accuse the long-distance company of failing **to** follow through on a promise to lower rates.") (available at http://www.thedigest.com/rnore/129/129-001.html).

customers' subscription decisions. The new charges would undermine the purpose of Section 254(g). Because they would be assessed by LECs, the new end-user charges would not be subject to the rate averaging requirement that is imposed only on IXCs. Without Commission action to preserve geographic averaging, which could require further revisions to universal service programs, the new charges could result in significant disparities between rural and urban rates. To the extent the Commission required customers to pay an additional flat rate for the ability to receive long distance calls, even if they do not receive or make many, the customers might decide connecting to the PSTN is too expensive. Alternatively, if customers must pay additional usage-sensitive rates for receiving long distance calls, they might refuse to make their telephone number available to the public or disconnect their voice mail or answering machine to avoid the costs of unsolicited calls. In short, the new charges could affect not only universal access to affordable telephone service, but also the ability to reach customers that remain on the PSTN. Allegiance believes that this massive new program of federal end-user charges, and potential re-regulation of non-dominant carriers, is by itself sufficient reason not to mandate bill-and-keep for access traffic.

C. Bill-and-Keep for Access Would Produce Opportunities for Regulatory Arbitrage

As discussed in Section V.C herein, the Commission may not direct state commissions to impose bill-and-keep for intrastate exchange access. Therefore, it is likely that even if the Commission establishes bill-and-keep for interstate exchange access, CPNP for intrastate exchange access will continue. In such an environment,

[105] Conf. Rpt. 104-458, at 1 **(1996)** ("to provide for **a** pro-competitive, de-regulatory national policy framework").

LECs and IXCs will have the incentive and ability to game the system to take advantage of opportunities created by different federal and state regulatory schemes.

If interstate access charges move to zero, as they effectively would under bill-and-keep. IXCs would have the incentive to classify traffic as interstate in order to avoid paying intrastate access charges. In an effort to prevent this behavior, ILECs would have the incentive to impose inefficient network and intrusive audit requirements on IXCs to police the accuracy of their Percent Interstate Usage ("PIU") reports.[106] Mandating bill-and-keep for interstate access could also increase ILEC incentives to game the separations process. Because state commissions retain jurisdiction over intrastate access charges. ILECs would have incentives to classify costs as subject to the state jurisdiction in order to impose such costs on other carriers, rather than their end-users. Thus the radically differing incentives created by mandating bill-and-keep at the federal level would result in significant new arbitrage opportunities.

Moreover, bill-and-keep for access, at least under COBAK, could create incentives for CLECs to deploy inefficient network architectures. COBAK requires IXCs to deliver terminating interstate access traffic to the LEC central office; bill-and-keep only applies for the local switching and termination functions the LEC performs. There is only one IXC, AT&T, who can come close to matching the ubiquitous dedicated facilities necessary to deliver long distance traffic to each and every ILEC central office.[107] Thus,

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[106] If an ILEC took such policing measures to an extreme, it might move the three categories of traffic subject to the unified federal regime to a single tandem and the one category that remains subject to a different regime to its own tandem. In other words, ILECs could avoid the PIU reporting problem by flipping the status quo and requiring all intrastate exchange access traffic to go through the access tandem and all interstate exchange access traffic to go through the local tandem, creating a major disruption to current network architectures and routing tables.

[107] *See, e.g., Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, CC Docket No. 96-98, Reply Comments of AT&T Corp. on Use of Unbundled Network Elements to

for over 50% of long distance traffic delivered to ILECs,[108] IXCs would still pay most terminating access rate elements (*e.g.*, tandem-switched transport (fixed), tandem-switched transport (per mile), and tandem switching). In short, an ILEC's exchange access costs would still be recovered from both end users and IXCs because of their historical network architecture. CLECs, on the other hand, typically deploy fewer switches and more transport to cover the same geographic area an ILEC covers using multiple tandem and end office switches. Because COBAK is premised on the ILECs' legacy network architecture, the CLEC whose network does not look like the ILECs' will be forced to recover virtually all of its exchange access costs from end users. Faced with the prospect of charging its end user more for interstate access or restructuring its network to recover some of its costs from IXCs, as the ILECs do, a CLEC may be forced to deploy additional. unnecessary switches.[109]

Nor would bill-and-keep for interstate access eliminate incentives for entities that primarily or exclusively receive traffic to claim to be a network rather than an end user. While bill-and-keep may slightly reduce the advantage IP telephony providers have over traditional IXCs,[110] it will not eliminate it. Under COBAK, ISPs that connect as end users and provide IP telephony would still avoid the terminating transport costs from

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Provide Exchange Access Services, v (filed Apr. 30,2001) (despite AT&T's significant efforts to use non-incumbent transport facilities, AT&T has special access circuits connecting its points of presence to approximately 1 1,500 local serving offices); *Joint Petition of BellSouth, SBC, and Verizon for Elimination of Mandatory Unbundling of High-Capacity Loops and Dedicated Transport*, CC Docket No. 96-98, WorldCom Comments, 15 (filed June 11, 2001) (alternative transport is available to less than 15% of RBOC wire centers).

108 In 1999, AT&T's share of the long distance market was only 40.7%. ***Statistics of the** Long Distance Telecommunications Industry*, Table **8** (Jan. 2001).

109 Although the cost of deploying additional circuit switches may not be justified, CLECs may take advantage of new technologies, such as packet switches, that could substantially reduce the cost of deploying such an inefficient network architecture.

their points of presence to the LEC central office serving the customer. Under BASICS, ISPs would still avoid negotiations that are supposed to result in a "split" of such transport costs. Even if bill-and-keep effectively does away with the need for the ESP access charge exemption, ISPs may still choose to connect as end users for fear of being classified as common carriers and becoming subject to other Title II obligations.

D. Bill-and-Keep for Access Would Favor ILECs

As discussed above, bill-and-keep could force a CLEC to recover virtually all of its exchange access costs from its end users rather than splitting such costs between the end user and IXC, as ILECs would continue to do. The increase in a CLEC's end-user rates could potentially price their local services out of the market.[111] Because universal service is assessed on charges to end users (but not other carriers) for interstate services, bi 11-and-keep would also increase a CLEC's contribution to universal service *vis-a-vis* an ILEC's.

X. The Commission Should Not Create Yet Another Regulatory Class of Traffic with Yet Another Intercarrier Compensation Mechanism

The Commission asks whether carriers should be permitted to use Virtual NXX ("VNXX") codes and if so, whether different intercarrier compensation obligations should apply for carriers who use such codes. Given the telephone number exhaust difficulties arising from the current practice of assigning telephone numbers in 10,000

110 The Commission must take responsibility for any advantage that IP telephony providers have over traditional IXCs. That advantage is the result of the ESP access charge exemption.

111 Of course, implementing bill-and-keep for CLECs' access charges prior to ILECs' would also favor ILECs. Because Section 254(g) prohibits IXCs from deaveraging rates based on the LEC serving the end users, and ILECs would still be recovering their exchange access costs from IXCs, CLEC end users would essentially be charged twice for interstate exchange access, once by the CLEC and a second time by the IXC. *See CALLS* at ¶ 52 (end users of price cap LECs that discontinued PICCs would pay higher overall rates because IXCs could not pass through a PICC to some end users and not others based on the price cap LEC that provided local service).

number blocks on a rate center basis. the Commission should not rush to condemn the use of VNXX codes. Maintaining existing reciprocal compensation for VNXX traffic is consistent with long-standing industry practice and based on cost as required by the Act. Pursuant to the FCC's recent *Reciprocal Compensation Order,* VNXX calls that are ISP-bound are subject to the interim intercarrier compensation regime set forth in the *Reciprocal Compensation Order.* To the extent that VNXX and Foreign Exchange ("FX")-like calls are not ISP-bound, the Commission should continue to treat such calls as eligible for reciprocal compensation under Section 251(b)(5). Because the ILEC's transport obligation is limited to delivering the call to the POI regardless of where the CLEC's customer is physically located, it is unclear why the Commission believes that ILECs are forced to incur additional transport costs when their customers call VNXX numbers.[112] It is the terminating, not the originating, carrier that bears the cost of transporting the call between the POI and the called party.

A. Because the New "Information Access" Regime Does Not Distinguish Between Local and Non-Local ISP-Bound Traffic, All Locally-Dialed ISP-Bound Calls Are Subject to the Same Compensation Mechanism

Prior to the *Reciprocal Compensation Order,* the Commission focused on whether ISP-bound traffic was "local" traffic subject to reciprocal compensation. In its *Reciprocal Compensation Order,* however, the Commission decided that under its precedent, the term "local call" "could be interpreted as meaning ... traffic subject to local rates" in addition to "traffic that is jurisdictionally intrastate."[113]

The Commission underscored that "local call'' is "not a term used in Section 251(b)(5) or Section 251(g)," is "susceptible to varying meanings," and "created

112 *NPRM* at ¶ 115.

unnecessary ambiguity because the statute does not define the term 'local call.'"[114] Rather than focusing on whether ISP-bound traffic is local, the Commission determined that "[m]ost Internet-bound traffic traveling between a LEC's subscriber and an ISP is indisputably interstate in nature when viewed on an end-to-end basis."[115] The Commission concluded that "information access" includes all traffic "routed by a LEC 'to or from' providers of information services, of which ISPs are a subset."[116] The Commission expressly declined to decide whether ISP-bound traffic is either "telephone exchange service," or "exchange access."[117] Thus, under current Commission rules and orders, "information access" traffic includes all ISP-bound traffic and any purported distinction between "local" ISP-bound traffic and non-local ISP-bound traffic has been rejected.

B. Calls to Non-ISP VNXX and FX-Like Customers Should Be Treated as Section 251(b)(5) Traffic Subject to Reciprocal Compensation

Following the *Reciprocal Compensation Order,* this issue is limited to intercarrier compensation arrangements for traffic that is delivered to a non-ISP customer who has subscribed to a local telephone number in a calling area where the customer has no physical presence. Both ILECs and CLECs offer customers the ability to obtain a local telephone number in a "distant" local calling area. ILECs offers several services that meet this need, including FX service, and CLECs' services are generally referred to as VNXX service.

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113 *Reciprocal Compensation Order* at ¶¶ 45-46, 54.

114 *Id* at ¶¶ 34, 45-46.

115 *Id.* at ¶ 58.

116 *Id.* at ¶ 44.

117 *Id.* at ¶ 30.

ILECs generally do not deny that CLECs are permitted to develop a product to respond to customer demand. Rather, this dispute is about the intercarrier compensation mechanism that should apply for traffic that is *dialed as local by the calling party,* rated as local at the retail level, and routed to non-ISP customers that are not physically located in the same calling area as the calling party. ILECs want to classify such calls as "special" toll calls and to collect originating access and/or transport charges from CLECs even though such calls have always been treated as local and even though the ILECs incur no additional origination or transport costs.

As explained further below, the Commission should make clear that LECs must compensate the terminating carrier for the services it provides the originating carrier's customers and prevent overcompensation to the originating carrier. Maintaining reciprocal compensation for calls to VNXX and FX-type customers is consistent with the historical industry practice of rating calls by comparing the NXX codes of the calling and the called parties. It is also cost-based, as required by Section 252(d) of the Act, and would avoid serious adverse consequences, such as expensive billing system changes and increased costs for business customers – and their own patrons in sparsely populated areas. The confusion, administrative expense and inconvenience that will result from the ILECs' proposal to create a new compensation mechanism for such traffic would be avoided by maintaining the standard industry practice of comparing NXX codes to rate a call as local or toll for all purposes.

1. <u>The ILEC Proposal Departs from Long-standing Industry Practice</u>

Customers like VNXX services (and FX services offered by ILECs) because such services permit them to obtain a telephone number in a local calling area where they do not have a physical presence. As far as the person calling a VNXX number is concerned, the call is "local," even though the party answering the call may be physically located in another exchange. When an ILEC customer makes a call to a CLEC VNXX number, the ILEC's switching software recognizes the call as a call to a CLEC local service customer and the ILEC delivers the call to the POI just like any other local call its customer places to a CLEC customer. The ILEC's switching software also recognizes the call as a local call, and bills its end user under its local calling rate plan. Consistent with that practice, BellSouth treated calls to its FX customers as local calls subject to reciprocal compensation and billed CLECs reciprocal compensation for these calls for four or five years (until February 2001).[118] Verizon *still* bills CLECs reciprocal compensation for calls to its FX numbers and in a proceeding before the Florida Public Service Commission it proposed to *continue* doing so even as it argued CLECs may not."'

CLECs seek to treat VNXX and FX calls as local calls, just as the ILECs do for retail purposes and just as the ILECs have treated their own FX services for years. **A** CLEC's use of VNXX codes allows it to offer a service comparable to the ILECs' FX service and to provide a competitive alternative to those businesses that find it desirable to obtain local numbers in several communities while maintaining a limited number of physical locations. It also benefits customers located in rural and sparsely populated areas by allowing them to reach a wider range of businesses and services without incurring toll charges.

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118 *investigation into Appropriate Methods to Compensate Curriersfor Exchange of Traffic Subject to Section 251 of the TelecommunicationsAct of 1996*, Docket No. 000075-TP (Phase II), **Joint** Brief of Allegiance Telecom of Florida, Inc. and Level 3 Communications, LLC, 29 (filed **Aug.** 10, 2001) (at http:llwww.psc.state.fl.us/psc/dockets/index.cfm?event=documentFilings&docket=000075&requestTimeout=240).

119 *Id.*

As noted above, because the ILECs' transport obligation is limited to delivering a VNXX call to the POI, they do not incur additional transport costs for such traffic. Creating a different intercarrier compensation mechanism for such traffic will impose unwarranted costs on all LECs by requiring billing system changes. If the Commission were to disturb the historical treatment of FX and VNXX calls, carriers would be required to make significant investments to modify their billing systems, protocols, and processes to accommodate this change. The Michigan Commission recently rejected Ameritech's proposal to reclassify FX and VNXX calls as non-local for reciprocal compensation purposes, in part because it was uncertain whether the necessary charges to billing systems "would be technically feasible at an affordable cost for both Ameritech Michigan and the CLECs."[120]

Several state commissions that have ruled on this issue have concluded that calls using VNXX codes should be treated as local calls and subject to reciprocal compensation just as any other locally-dialed call. For example, the North Carolina Utilities Commission ("NCUC") recently ruled that VNXX services should be treated as local traffic subject to reciprocal compensation. Specifically, the NCUC held:

> The Commission believes that the question which the Commission needs to decide in this issue is whether a telephone call from a BellSouth customer physically located in one rate center to a MCIm customer physically located in a different rate center but who has a NPA/NXX code from the same rate center as the caller placing the call is a local call or a long distance call. The Commission believes that based on the evidence presented in this case . . . the calls in question to the extent they are within a **LATA** should be classified as local and, therefore, subject to reciprocal compensation. The Commission notes that NPA/NXX codes were developed to rate calls and, therefore, *MCIm's assertion that whether a*

[120] *Application of Ameritech Michigan to Revise Its Reciprocal Compensation Rates and Rate Structure and to Exempt Foreign Exchange Service from Payment of Reciprocal Compensation,* Case No. U- 12696, 10-11 (Mich. PSC Jan. 23,2001).

call is local or not depends on the NPA/NXX dialed, not the physical location of the customer, is reasonable and appropriate.[121]

Similarly, the Kentucky Public Service Commission found that CLEC VNXX service should be treated the same as BellSouth's FX service, and both services should be treated as local traffic.

> Both utilities offer a local telephone number to a person residing outside the local calling area. BellSouth's service is called foreign exchange ("FX") service and Level 3's service is called virtual NXX service. The traffic in question is dialed as a local call by the calling party. BellSouth agrees that it rates foreign exchange traffic as local traffic for retail purposes. These calls are billed to customers as local traffic. If they were treated differently here, BellSouth would be required to track all phone numbers that are foreign exchange or virtual NXX type service and remove these from what would otherwise be considered local calls for which reciprocal compensation is due. This practice would be unreasonable given the historical treatment of foreign exchange traffic as local traffic.
>
> Accordingly, the Commission finds that *foreign exchange and virtual NXX services should be considered locul traffic* when the customer is physically located within the same LATA a[s] the calling area with which the telephone number is associated.[122]

Both of these decisions are consistent with the result reached by the Michigan Public Service Commission.[123] In Michigan, the Commission found that the use of a VNXX arrangement does not impact the ILEC's financial and/or operational

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121 *Petition of MCImetro Access Transmission Services, LLC for Arbitration of Certain Terms and Conditions of Proposed Agreement with BellSouth Telecommunications, Inc. Concerning Interconnection and Resale Under the Telecommunications Act of 1996,* Docket No. P-474, Sub 10, Recommended Arbitration Order, 74 (N.C.U.C., adopted Apr. 3, 2001).

122 *Petition of Level 3 Communications, LLC for Arbitration with BellSouth Telecommunications, Inc. Pursuant to Section 252(b) of the Communications Act of 1934, as Amended by the Telecommunications Act of 1996,* Case No. 2000-404, Order, 7 (Ky. PSC March 14, 2001) (emphasis added).

123 *Application of Ameritech Michigan to Revise Its Reciprocal Compensation Rates and Rate Structure and to Exempt Foreign Exchange Service from Payment of Reciprocal Compensation,* Case No. U-12696, 8-11 (Mich. PSC Jan. 23, 2001).

responsibilities, and that under the VNXX framework, the costs to the ILEC do not differ, but are "the same as when the call is undisputedly local."[124]

The ILECs' focus on the location of the called party is meaningless **for** purposes of determining cost-based compensation because the originating party only transports the call to the POI, not all the way to the called party, regardless of whether the called party uses VNXX service or regular local service. The called customer's location will not cause the originating carrier's costs or functions to differ. There will be no difference in an ILEC's costs when one of its customers dials a CLEC customer who happens to reside physically outside the local calling area as compared to any other CLEC customer who resides physically within the same local calling area.

Since the ILEC incurs no additional transport obligations when one of its customers originates a call to a CLEC customer with a VNXX number, it should be economically indifferent as to whether the call terminates to a virtual NXX. If the customer is physically located in a distant calling area, the terminating party – not the originating party – bears any additional cost of delivering the call to the customer.

2. <u>ILECs Should Not Be Made Whole for Losses Resulting from Competition</u>

The real thrust of the ILECs' argument on this issue is not always clearly stated, but is nonetheless evident. This is a revenue issue, not a cost issue. ILECs simply want to recover lost toll revenues, and if they cannot recover them from a customer they will gladly recover them from the CLEC instead. When an ILEC provides FX service, the FX subscriber pays the ILEC for the transport of the call over the private line to the distant

[124] *Petition of Coast to Coast Telecommunications. Inc., for Arbitration of Interconnection, Rates, Terms, Conditions, and Related Arrangements with Michigan Bell Telephone Company, d/b/a Ameritech Michigan,* Case No. U-12382, Order Adopting Arbitrated Agreement, 9 **(Mich.** PSC Aug. 17,2000).

local calling area. If the ILEC customer did not purchase FX service, callers in the "foreign" local calling area would pay have to pay toll charges to call the customer. When the ILEC customer does purchase FX service, the ILEC loses toll revenue (because the call is now rated as local) but gains FX revenue. **As** long as the ILEC provides the service to both the calling and called parties, it is willing to forego its toll revenue from the party initiating the "toll" call.

In a competitive environment, the ILECs' traditional method of offsetting lost toll revenue with FX revenue breaks down. The CLEC, not the ILEC, is serving the called party and is delivering the call from the POI to the "distant" location of the called party. The ILECs, however, still want to recover the lost toll revenue even though they are only providing a local service; that is, originating the call and delivering it to the POI just like any other local call. In short, the ILECs seek to recover lost toll revenue despite the fact that they are not incurring any additional costs that resemble those associated with a toll call.

The ILECs' desire to recover lost toll revenue as an entitlement is not a basis for establishing a different compensation mechanism for VNXX traffic. Perhaps **an** ILEC can seek to recover lost revenues when ***its own*** *customer buys* a service that eliminates toll charges, but it would be inequitable to allow the ILEC to recover its lost revenue from the CLEC, where the CLEC is incurring the additional cost to transport the VNXX calls to the terminating location. In a competitive market, when a company loses a customer, it also loses revenue.

XI. Conclusion

The Commission is charged with implementing regulations that are consistent with both the letter and the spirit of the Act. The Act requires that the Commission adopt rules to open telecommunications markets to competition and to ensure that ILECs do not abuse their monopoly in the local exchange market to the detriment of competition in all telecommunications markets. In shepherding the transition to competition, the Commission has historically relied on new entrants to place pressure on incumbents' rates and expressed a preference for rates that recover costs in the manner in which they are incurred. The fact that the Commission, and state commissions, may not always get the rate and rate structure "right" is no justification for not trying. For the reasons specified herein, the Commission should maintain its unified CPNP intercarrier compensation regime.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I, Wendy Mills, hereby certify that on this 21st day of August, 2001, the foregoing Comments of Allegiance Telecom, Inc. was served to the following **(except as indicated):**

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